INTERIM STUDY COMMITTEE ON MORTGAGE LENDING PRACTICES AND HOME LOAN FORECLOSURES

Legislative Services Agency
200 West Washington Street, Suite 301
Indianapolis, Indiana 46204-2789
Tel: (317) 233-0696 Fax: (317) 232-2554

MEETING MINUTES[1]

Meeting Date:	**August 16, 2007**
Meeting Time:	**10:30 A.M.**
Meeting Place:	**State House, 200 W. Washington St., Room 431**
Meeting City:	**Indianapolis, Indiana**
Meeting Number:	**1**

Members Present: **Sen. Connie Lawson, Chairperson; Sen. Greg Walker; Sen. Timothy Lanane; Sen. Richard Young; Rep. Jeb Bardon, Vice-Chairperson; Rep. Matt Pierce; Rep. Joseph Micon; Rep. Michael Murphy; Rep. Woody Burton; Rep. Randy Borror.**

Members Absent: **Sen. Allen Paul; Sen. Frank Mrvan.**

Senator Connie Lawson, Chair of the Interim Study Committee on Mortgage Lending Practices and Home Loan Foreclosures, called the meeting to order at 10:40 a.m. Senator Lawson invited members of the Committee to introduce themselves and identify the districts they represent. Following these introductions, Senator Lawson announced that the meeting's agenda would include a discussion of: (1) the causes of home loan foreclosures in Indiana; and (2) the influence of property taxes on foreclosures among newly constructed homes.

---

[1] Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of $0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is http://www.in.gov/legislative/. No fee is charged for viewing, downloading, or printing minutes from the Internet.

(1) Overview of Home Loan Foreclosures in Indiana

After setting forth the agenda, Senator Lawson asked Sherry Seiwert, Executive Director of the Indiana Housing and Community Development Authority (IHCDA), to provide an overview of home loan foreclosures in Indiana. Ms. Seiwert cited data from the Mortgage Bankers Association indicating that 2.98% of all loans in Indiana are in foreclosure,[2] compared to a national foreclosure rate of 1.28%. This statistic places Indiana second in the nation among the states with the highest foreclosure rates. Two other Midwestern states, Ohio and Michigan, have the first and third highest foreclosure rates, respectively. Ms. Seiwert noted that loans in Ohio, Indiana, and Michigan account for 8.7% of all mortgages issued in the United States, while loans in foreclosure in those states account for 19.9% of all mortgages in foreclosure nationally. Of the loans in foreclosure in Indiana in the first quarter of 2007, 47% were subprime loans, 33% were prime loans, 17% were Federal Housing Administration (FHA) insured loans, and 3% were VA loans.[3]

While ranking near the top in terms of high foreclosure rates, Indiana ranks among the bottom five states with respect to home value appreciation rates. Ms. Seiwert suggested that the low appreciation rate in Indiana could be one of several factors contributing to the state's higher foreclosure rate.

After describing the extent of the foreclosure problem in Indiana, Ms. Seiwert reminded the Committee that with the enactment of HEA 1753 (2007), the legislature authorized the IHCDA to establish a program to provide free mortgage foreclosure counseling to homeowners. Accordingly, the IHCDA has been working to promote the program and to establish a toll free telephone number that homeowners can call for foreclosure prevention counseling.

Ms. Seiwert then introduced Seth Payton, Senior Policy Analyst at the Center for Urban Policy and the Environment (CUPE), who presented the results of a study he conducted on statewide patterns of foreclosures.[4] Mr. Payton explained that CUPE had originally performed a twelve-county study of foreclosure patterns in central Indiana for the Metropolitan Indianapolis Board of Realtors (MIBOR). The IHCDA then commissioned CUPE to perform a similar statewide analysis. In performing both studies, CUPE examined whether foreclosures were concentrated in certain areas and, if so, in what kind of environments they occurred.

Mr. Payton explained that he used Foreclosure.com to obtain data on Indiana foreclosures from 2002 through 2005. After reviewing over 39,400 records, Mr. Payton mapped out the data in block groups, or concentrations, across the state. In describing this mapping process to the Committee, Mr. Payton displayed statewide maps for each year from 2002 through 2005, with each map using different colors to illustrate different concentrations of foreclosed properties. Mr. Payton noted that the foreclosure rates studied represented the percentage of foreclosures among all residential units in an area, not the percentage of foreclosures per mortgage loans in the area. All of the maps revealed a higher concentration of foreclosures in urban areas, with the highest rates in areas of Marion County and into Johnson County. The maps also showed a progressive spreading of higher concentration areas throughout the state with each passing year.

---

[2]See Exhibit 1.

[3]See Exhibit 2.

[4]See Exhibit 3.

Mr. Payton observed that the data showed that areas with higher concentrations of foreclosures had higher percentages of low income residents. For example, in those areas above the 90th percentile in terms of foreclosure rates, 39% of the households earn $25,000 or less, compared with 28% of households that earn $25,000 or less statewide. Similarly, in those same areas, 25% of households spend more than 30% of their income on mortgage costs, versus 19.6% of households that spend that proportion statewide.

Mr. Payton additionally reported that areas with high concentrations of foreclosures also tend to occur in neighborhoods in which: (1) the housing supply outstrips demand; (2) homes prices range from $80,000 to $120,000; (3) home prices are declining or appreciating at a slower rate; or (4) there is a high rate of property abandonment.

In response to a question from Representative Murphy about the effect of foreclosures on the price of neighboring homes, Mr. Payton explained that in the average neighborhood, there are approximately 50 foreclosures within one mile of any given property. In such a neighborhood, the surrounding foreclosures result in a decrease in value of about $3,200, or 4%, for a home that is not in foreclosure. This effect declines as a home's distance from foreclosed properties increases.

Representative Borror then asked whether Ohio, Indiana, and Michigan rank as the top three states in terms of mortgage foreclosures because of their dependency on declining manufacturing jobs. Mr. Payton replied that he was uncertain of whether there was a correlation between the type of employment in an area and foreclosure rates. However, he noted that the number of foreclosures tend to be greater under the following conditions: (1) In states whose foreclosure laws involve the judicial process, because properties tend to move more slowly through the process, resulting in more properties being in foreclosure at any given time. (2) When certain types of loan products are involved, such as adjustable rate mortgages (ARMs) and loans with a high loan-to-value (LTV) ratio. (3) When mortgage fraud is involved. (4) When the mortgage involves a low income borrower. (5) In areas in which home values are declining or appreciating at a low rate.

Finally, Representative Burton asked whether Mr. Payton had observed any difference in foreclosure rates between newly constructed homes and previously owned homes. Mr. Payton responded that such data is difficult to obtain, because not all newly constructed homes are listed through the Multiple Listing Service (MLS).

(2) Definitions and Technical Terms

After Mr. Payton concluded his presentation, Senator Lawson invited Thomas Dinwiddie, an attorney for the Indiana Mortgage Bankers Association, to provide the Committee with an explanation of some of the definitions and technical terms used in the mortgage industry. Mr. Dinwiddie distributed a handout[5] explaining the difference between the various lenders and participants in the home loan process, including mortgage bankers, mortgage brokers, credit unions, consumer finance companies, and banks.

Mr. Dinwiddie then described the history of mortgage lending in the United States. He explained that the amount of the down payment that borrowers are required to provide to close a loan has been decreasing steadily since World War II. The standard down payment has decreased from 20% of the purchase price of the home, to 10%, and now to 5%, which is common even in the prime market today. In the subprime market, many loan products do not even require a down payment. Mr. Dinwiddie further noted that before

---

[5] See Exhibit 4.

World War II, money for home loans primarily was issued by domestic, depository institutions. In today's market, the money comes from a variety of sources, including international funds and institutions. According to Mr. Dinwiddie, the loans themselves have also evolved. While fixed rate loans were the only option for borrowers before World War II, since then a variety of ARMs have entered the market, and are especially common in the subprime market.

Turning to the evolution of the subprime market, Mr. Dinwiddie explained that the proliferation of subprime loans in recent years has been partly in response to the nationwide focus on encouraging homeownership. According to Mr. Dinwiddie, by making loans available to less creditworthy borrowers, the subprime industry has indeed led to record levels of homeownership. He reported that Indiana has a homeownership rate of approximately 75%, one of the highest in the nation.

With more high-risk borrowers owning homes, the number of loan defaults has correspondingly increased. However, Mr. Dinwiddie pointed out that in Indiana, the high foreclosure rate is not as highly correlated with the subprime market as it is in other states. Rather, Indiana's 2.98% foreclosure rate is largely connected with a loss of manufacturing jobs, a low home-price appreciation rate, and a loan mix that consists of a high percentage of low-down payment loans. He noted that among the low-down payment loans in Indiana, a high percentage of them are FHA loans, which are associated with higher foreclosure rates throughout the country.

Finally, Mr. Dinwiddie emphasized that lenders are motivated to avoid the foreclosure process, because they typically lose money in such proceedings. Rather, it is in a lender's best interest to work with a borrower to ensure that the borrower can continue making payments on the loan.

Representative Murphy then asked whether loan originators face pressure by their employers to meet quotas with respect to the number or value of loans originated, or whether they receive incentives or commissions for meeting certain targets. Mr. Dinwiddie responded by noting that the loan process is initiated by borrowers. Representative Murphy countered that in the case of new construction, home builders essentially offer loan products to captive buyers. Mr. Dinwiddie noted that the mortgage foreclosure problem is not confined to new home construction and cannot be blamed on builders.

Senator Lanane wondered whether the fact that home loans are being bundled and sold on the secondary market has led lenders to be less careful in evaluating borrowers' ability to repay loans. Mr. Dinwiddie surmised that to the extent a lender anticipates selling a loan, the lender would be less concerned about the borrower's ability to repay, since the loan would not remain in the lender's portfolio.

Representative Borror asked for the historical context in which loan brokers came to be regulated by the Indiana Secretary of State. Mr. Dinwiddie explained that Indiana's loan broker law was enacted in 1985, at which time lawmakers were focused on regulating brokers that offered to obtain loans for troubled businesses. According to Mr. Dinwiddie, because the origination activity was occurring with respect to business loans, rather than consumer loans, the Securities Commissioner was determined to be the appropriate regulator. Senator Lawson then reminded the Committee that the issue of regulation of brokers would be discussed at a future meeting.

(3) Indiana Association of Realtors' Study of Home Loan Foreclosures

Senator Lawson next asked Sally Johnson, Government Affairs Director for the Indiana

Association of Realtors (IAR), to discuss the IAR's study of home loan foreclosures in Indiana.[6] Ms. Johnson explained that in 2004, the IAR, in conjunction with the National Association of Realtors, published a study that examined the causes of the disparity between Indiana's foreclosure rate and the national foreclosure rate. In August 2007, the data from this study was updated and revealed that the gap between Indiana's foreclosure rate (3.0%) and the national foreclosure rate (1.1%) had widened over the past year. According to Ms. Johnson, the new study suggests that five key factors have contributed to this widening gap: (1) job losses in Indiana; (2) the number of first-time home buyers in Indiana; (3) loans with high LTV ratios; (4) the state's slow rate of home price appreciation; and (5) certain lending practices.

Ms. Johnson briefly discussed a few of these factors, including the correlation between the number of first-time home buyers in Indiana and the state's foreclosure rate. Ms. Johnson pointed out that Indiana's homeownership rate in 2006 was 72%, versus 68% nationally. According to Ms. Johnson, Indiana's higher homeownership rate may be associated with a greater number of first-time homebuyers in the state. Because these homebuyers typically make smaller down payments and take on mortgages with higher rates, they are more susceptible to default and foreclosure, especially if the job market weakens.

Ms. Johnson also noted that Indiana has experienced a much lower rate of home price appreciation, compared to the rest of the country. In the Indianapolis market, for example, houses sell at an approximate 44% discount compared to houses in similar sized markets nationally. This low appreciation rate results in loans with higher LTV ratios, which in turn are associated with higher rates of foreclosure.

With respect to the impact of lending practices on foreclosure rates, Ms. Johnson stressed that predatory lending is hard to quantify and define, making its impact on the foreclosure rate difficult to determine. However, she noted that in August, the Indiana Secretary of State and the Department of Financial Institutions (DFI) adopted regulatory guidance for originators that market and sell certain ARM products to subprime borrowers. The guidance applies to lenders not regulated by federal financial regulatory agencies.

Finally, Ms. Johnson emphasized the importance of consumer education in addressing Indiana's high foreclosure rate. She reported that the IAR has prepared a consumer "toolkit" for local realtor boards to distribute to home buyers.

Senator Young asked whether the IAR had discovered any difference in foreclosure rates with respect to mortgages on new homes, versus mortgages on previously owned homes. Ms. Johnson indicated that she did not have any statistics concerning new versus previously owned homes, but she offered to further research the issue for the Committee.

Representative Murphy then asked whether realtors have any responsibility to dissuade a person from buying a home they know the person cannot afford, especially in light of the fact that realtors receive larger commissions from higher priced homes. Ms. Johnson responded that because realtors depend on their reputations to receive additional business, they typically encourage potential buyers to seek pre-qualification from lenders at the start of the home buying process.

Turning to the risky nature of certain mortgage products, Representative Pierce noted that in the case of consumer products, the Consumer Product Safety Commission outright prohibits the sale of defective products to consumers. Representative Pierce wondered

---

[6] See Exhibit 5.

why federal and state regulators have allowed certain mortgage products to be marketed to consumers in the first place. He suggested that some loan products are so detrimental to borrowers that they should be removed from the marketplace.

(4) Federal Regulations

Following Ms. Johnson's presentation, the Committee heard from Amber Van Til, Vice President of Government Relations for the Indiana Bankers Association (IBA).[7] Ms. Van Til began by distributing statistics concerning various types of loans issued by federally regulated commercial banks and thrifts in Indiana from 2002 through the first quarter of 2007,[8] including the percentage of the various types of loans that were foreclosed.

After discussing the various foreclosure statistics, Ms. Van Til explained that as depository institutions, the IBA's member institutions issue mostly prime loans. She then cited the top reasons for foreclosure among borrowers of loans issued by depository institutions: (1) job loss or loss of income; (2) divorce; (3) death; (4) medical crises, including lack of health insurance or loss of income due to time off for medical reasons; and (5) poor money management, including credit card debt and bankruptcy.

Ms. Van Til then described recent guidance to lenders issued by the federal financial regulatory agencies: the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Association (NCUA), and the Federal Reserve Board.

First, the agencies issued the "Interagency Guidance on Nontraditional Mortgage Product Risks" on October 4, 2006. This guidance sets forth standards that should be followed in underwriting "nontraditional loans," such as interest-only loans and "payment option" ARMs.[9] On November 14, 2006, the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) issued parallel guidance for state-regulated lenders. Both sets of guidelines provide that originators should, among other practices: (1) analyze a borrower's repayment ability based on the fully indexed interest rate for the mortgage; (2) alert consumers to the risks of particular products in a timely manner to assist them in the product selection process; (3) provide clear and balanced information about the risks of products in all communications with consumers; and (4) inform consumers of potential increases in payments, including payment obligations once interest rate and negative amortization caps have been reached.

On June 29, 2007, the federal agencies issued their "Statement on Subprime Mortgage Lending,"[10] which was followed by a similar statement issued by CSBS, AARMR, and the National Association of Consumer Credit Administrators (NACCA) on July 17, 2007. As had been noted by Ms. Johnson, on August 9, 2007, the Indiana Secretary of State and the DFI adopted the guidance issued by CSBS, AARMR, and NACCA. While substantially mirroring the federal statement, the CSBS/AARMR/NACCA guidance modified the

---

[7]See Exhibit 6.

[8]See Exhibit 7.

[9]A payment option ARM gives the borrower the option to make different types of monthly payments, such as interest-only payments or payments less than the amount of the monthly accrued interest.

[10]See Exhibit 8.

statement to apply to non-depository lenders and brokers who originate loans but do not hold them in portfolio, and who are typically regulated by the states. Both sets of subprime guidelines require lenders to provide consumers with information concerning payment shock, responsibility for taxes and insurance, prepayment penalties, balloon payments, and increased costs associated with stated-income or reduced-documentation loans.

Ms. Van Til noted that the CSBS/AARMR/NACCA guidance includes a list of characteristics that often identify a subprime borrower, including a recent history of delinquencies, foreclosure, or bankruptcy; a credit score of 660 or less; or a debt-to-income ratio or 50% or greater.

Representative Murphy pointed out that he had proposed legislation during the 2007 session that would have required lenders to provide educational materials to potential home buyers with a credit score below 620. He suggested that his proposal seems reasonable now in light of the 660 threshold referenced in the guidance. Ms. Van Til responded that a similar effort in Cook County, Illinois, had been tried and then terminated, after objections that it would make it harder for people to buy and sell homes.

(5) Home Loan Foreclosures and New Home Construction

After learning the perspective of the banking industry, the Committee turned its attention to the home construction industry, as represented by Mike Hannigan, President of The Hannigan Company, LLC. Explaining that he had over 40 years experience in the housing industry, Mr. Hannigan noted the cyclical nature of the housing market. He opined that the introduction of risky, nontraditional mortgage products in recent years represents an erosion of common-sense business principles. He cautioned legislators to be cautious about addressing the current situation through regulatory action, urging them instead to let the housing market correct itself. Mr. Hannigan suggested that market forces themselves would lead to a return to more responsible lending practices.

In closing, Mr. Hannigan reminded lawmakers that it is not possible for them to protect citizens from certain economic misfortunes. He noted that some foreclosures would always be inevitable due to illness, divorce, and other personal crises faced by borrowers. In response to these observations, Representative Murphy suggested that legislators are not trying to protect borrowers from unfortunate circumstances or bad financial decisions. Rather, Committee members are interested in protecting consumers from deceptive or aggressive practices on the part of lenders.

Following Mr. Hannigan's remarks, Senator Lawson invited comments from Rick Wajda, CEO of the Indiana Builders Association.[11] Mr. Wajda first addressed concerns that the Indiana housing market is saturated with newly built homes. Mr. Wajda acknowledged that there are high levels of inventory at certain price points in certain markets in Indiana. He pointed to the ample supply of starter homes in the Fort Wayne market as an example. However, Mr. Wajda explained that these high-inventory areas are the result of homes that have been in the construction pipeline for the past two years coming onto the market at the same time. He further pointed out that the market has recently been correcting itself: the number of new home permits in Indiana fell 28% from 2006 to 2007, and builders have been pulling out of the Central Indiana market. Acknowledging the Committee's focus on the Indiana housing market, Mr. Wajda emphasized that the increase in mortgage foreclosures is a global problem. He noted that one of the outcomes of the high foreclosure rates has been a drying up of the subprime market.

---

[11] See Exhibit 9.

Mr. Wajda then turned to the issue of property taxes for newly constructed homes. He pointed out that property taxes were not among the top five reasons for foreclosures cited by Ms. Van Til of the Indiana Bankers Association. Rather, he reiterated Ms. Van Til's assertion that job losses and credit card debt are more likely to cause a borrower to default on a mortgage.

Mr. Wajda stated that his association's members remain opposed to any legislation that would require builders to provide property tax estimates to home buyers. Citing the difficulty of predicting the value at which a home will ultimately be assessed, he stressed that builders are not in a position to provide accurate estimates to buyers. However, he conceded that it is in builders' best interest to deal with informed buyers. To that end, the Indiana Builders Association has developed a homeownership brochure for its members to provide to potential buyers. Mr. Wajda then distributed a similar brochure produced by the Builders Association of Greater Indianapolis and the Metropolitan Indianapolis Board of REALTORS.[12]

At that point, Representative Murphy commented that the 2007 proposed legislation to require builders to provide property tax estimates had contained a provision absolving builders from liability for the estimates provided. Mr. Wajda allowed that such a provision had been included, but argued that builders could lose business or suffer harm to their reputations if buyers felt that the estimates were inaccurate.

After Mr. Wajda had concluded his comments, the Committee received testimony from Chris Beaumont, Vice President of Government Affairs for the Indiana Credit Union League (ICUL). Mr. Beaumont acknowledged that the sudden increase in property taxes on new homes after they are fully constructed, combined with upwardly adjusting ARMs, can create financial difficulties for new home purchasers. He further acknowledged that a disclosure explaining the increase in property taxes on a fully improved lot can be valuable in protecting potential buyers from payment shock. However, he noted the dilemma that legislators face in determining who should provide the disclosure, when it should be given, and what it should be required to say.

Mr. Beaumont expressed appreciation for the fact that legislators had amended the 2007 bill to require that the estimate include a range of potential property tax figures, rather than a single estimate. He also acknowledged that legislators had absolved builders (and then lenders, after the bill was amended) from liability for the estimates provided. However, as argued by Mr. Wajda, he stressed that nothing could be done legislatively to shield builders or lenders from the "reputation risk" that they would necessarily assume in having to provide estimates of future taxes. Furthermore, he suggested that such legislation, to the extent it were to apply to federally regulated institutions, could ultimately be preempted by federal regulators. In that case, state chartered institutions would be at a competitive disadvantage, in that they would have to assume a risk-inherent duty from which federally chartered institutions would be exempt.

In light of these concerns over legislatively mandated property tax estimates, Mr. Beaumont reported that the ICUL had collaborated with builders, banks, and other lenders to prepare a proposed statement that could be distributed to potential buyers of new homes. He then distributed to the Committee a statement entitled, "What You Should Know About Indiana's Taxation of Newly Constructed Homes."[13]

---

[12]See Exhibit 10.

[13]See Exhibit 11.

Representative Murphy noted that the proposal before the 2007 General Assembly would have required lenders to simply provide a form generated from the website of the Department of Local Government Finance (DLGF). He then asked whether credit unions and other lenders took property taxes into account in underwriting loans. Mr. Beaumont replied that lenders use a "ballpark" figure that plays some role in the lending decision, but that such a figure is not publicly disclosed.

Noting the complexity of estimating property taxes for newly constructed homes, Senator Lawson asked for the insight of Barry Wood, Director of Assessment for the DLGF. Mr. Wood explained that in assessing property, assessors have to base the assessed value on the purchase price. He noted that a property's assessed value depends largely on *when* it is assessed.

Mr. Wood urged legislators to encourage their constituents to apply for the homestead and mortgage exemptions. He also reminded the Committee that in 2008, the 2% "circuit breaker" enacted by the General Assembly would go into effect, providing additional relief for homeowners.

Senator Lawson asked Mr. Wood how difficult it would be for the DLGF to establish a calculator on its website that would enable builders or lenders to generate the type of estimates contemplated by the 2007 legislation. Mr. Wood indicated that it would not be very complicated or time-intensive to provide such a tool.

There being no further questions from the Committee, Senator Lawson concluded the meeting's testimony and reminded legislators that the next meeting would focus on mortgage fraud and the regulation of the various participants in the mortgage lending process. The meeting was adjourned at 2:10 p.m.